MESQUITE EXPLORATION LTD.

2001 annual report

Corporate Profile

Mesquite Exploration Ltd. is a Calgary based oil and gas exploration and development company operating In Alberta and Saskatchewan. Mesquite's shares trade on the TSX Venture Exchange under the trading symbol "MQL".

Highlights

Twelve months ended December 31	**2001**	**2000**	**% Increase**
Revenues (000's)			
Production revenues	$11,899	$4,688	154 %
Operations			
Boepd(6:1) Average production	1,306.3	522.1	150 %
Exit volumes on December 31	1,808.0	940.0	92 %
Average price per BBl of light oil	$39.08	$45.07	
Operating costs per Boe (net)	$7.75	$5.62	
Field net back per Boe	$16.35	$19.66	
Cash flow	$5,566	$3,156	76 %
Reserves P + ½ probable (Mboe)	3,220.9	1,379.9	133 %
Reserve value @ 15% disc NPV	$32,815	$18,615	76 %
Cash F & D per established Boe	$ 9.62	$ 8.57	

- Average production for December 2001 was 1,479 Boepd. 2 new gas wells began production during the final week of December resulting in an exit volume for 2001 of 1,808 Boepd.
- 13 wells drilled (net 6.3) with 61.5% success rate.
- 2,317,800 Boe of established reserves were added in 2001, 476,811 were produced.
- Tax pools of over $20 million available to reduce future taxable income.

(complete highlights in MD&A section)

Highlights *for the years ended December 31, 2001 and 2000*

As at December 31, 2001

(Unaudited)	Twelve month period 2001	2000	By quarters 4th Qtr - 2001	3rd Qtr - 2001	2nd Qtr - 2001	1st Qtr - 2001
Production:						
Light oil (bbls/d)	736.3	233.1	792.3	735.3	717.1	699.6
Heavy oil (bbls/d)	271.3	245.7	262.9	235.9	276.4	310.8
Gas (boe/d at 6:1)	251.6	38.5	285.3	307.4	316.6	94.4
Liquids (bbls/d)	47.1	4.8	58.1	63.1	52.8	13.9
	1,306.3	522.1	1,398.6	1,341.7	1,362.9	1,118.7
Total BOE produced	476,811	191,089	128,667	123,439	124,023	100,682
Prices:(per bbl/mcf)						
Light oil	$39.08	$45.07	$31.68	$40.12	$42.23	$43.33
Heavy oil *	$14.36	$22.83	$10.25	$22.30	$14.03	$12.00
Gas	$4.96	$4.76	$3.25	$3.72	$6.47	$9.38
(* prices are net of processing and hedging difference)						
Per BOE						
Operating costs (gross)	$8.61	$5.62	$8.27	$13.07	$6.70	$5.92
Operating costs (net)	$7.75	$5.62	$7.91	$11.90	$5.52	$5.18
Field net back	$16.35	$19.66	$11.43	$12.93	$20.78	$21.35
Cash flow	$11.67	$17.02	$8.30	$8.08	$14.59	$16.78
Financial: ($000's Cdn)						
Production revenue	11,899	4,688	2,535	3,210	3,408	2,746
Other income	33	43	5	14	7	7
Gross operating expenses	(4,104)	(1,043)	(1,064)	(1,613)	(831)	(596)
G & A expenses	(1,557)	(460)	(259)	(386)	(592)	(320)
Interest expenses	(705)	(72)	(149)	(227)	(182)	(147)
Cash flow	5,566	3,156	1,068	998	1,810	1,690
DD & A	(5,553)	(1,105)	(2,077)	(1,225)	(1,318)	(933)
Future tax (expense) recovery	96	239	422	(214)	607	(719)
Gain (loss) on disposal	64	188	-	-	-	64
Earnings (loss)	173	2,478	(587)	(441)	1,099	102
Weighted average (converted)						
Outstanding shares:	17,157,742	11,820,827	18,163,374	17,324,523	17,146,163	15,970,986
Cash flow per share (basic):	$0.32	$0.27	$0.06	$0.06	$0.11	$ 0.11
Earnings (loss) per share (basic):	$0.01	$0.21	$(0.03)	$(0.03)	$0.06	$ 0.01

Highlights *for the years ended December 31, 2001 and 2000*

(Unaudited) Years ended December 31	2001	2000	1999
Proven reserves:			
Cash spent on P&N expenditures ($000's Cdn)	$22,289.5	$9,889.7	$878.0
Reserve additions (Mboe - proven)	2,030.2	941.9	303.1
All in finding costs ($/Boe) *(Includes acquisitions and f & d)*	$10.98	$10.50	$2.90
Ending reserves (Mboe)			
Proven - oil	1,600.1	1,045.4	308.3
- gas and liquids	1,070.0	71.3	39.0
	2,670.1	1,116.7	347.3
Probable - oil	795.1	514.9	85.4
- gas and liquids	306.4	11.5	19.8
Produced	(476.8)	(191.0)	(48.7)
Disposals	(52.0)	-	(20.2)

	As of Dec 31, 2001		As of years ended	
Net asset value ($000's Cdn)	12% DCF	15% DCF	2000	1999
Proven reserves	31,339.0	28,764.0	14,597.0	3,018.4
Probable (50% risked)	4,730.5	4,050.5	4,018.0	373.4
Undeveloped lands	1,196.3	1,196.3	180.0	148.5
Geophysical data	4,037.4	4,037.4	3,825.0	3,740.5
Working capital (deficit)	(1,901.1)	(1,901.1)	(646.0)	(229.1)
Investments	-	-	196.0	2,068.6
Long term debt	(12,380.5)	(12,380.5)	(2,675.0)	-
Net asset value	27,021.6	23,766.6	19,495.0	9,120.3
Outstanding shares (000's) basic as of December 31	18,723.0	18,723.0	13,741.8	11,437.1
NAV per share	$1.44	$1.27	$1.42	$0.80

* 1999 and 2000 reserves are escalated prices @ 15% DCF

**Gas is converted at 6:1 in keeping with industry's change

*** Tax pools in excess of $20 million are not included in NAV determination

President's Message to Shareholders

2001 Annual Review and 2002 Outlook

The year 2001 was an eventful year that touched us all, in one way or another. It was also a year that will be noted for significant volatility in commodity prices and market uncertainty. Despite this business environment, Mesquite Exploration Ltd. was able to achieve significant growth over the year 2000.

While operational delays in both waterflood enhancements and gas tie-ins caused lower than expected results, compared to the year 2000, the Company achieved an increase in average production of over 150%, cash flow of 76% and growth in established reserves of 133%.

Through the continued development of the assets assembled through 2000 and early 2001 in the Mitsue, Progress and Utikuma areas of Alberta, the Company exited the year at over 1800 Boe/d (using a gas to oil ratio of 6:1), compared to just over 940 Boe/d at December 2000.

As well, through the results of the drilling program at Medicine Lodge, the Company saw significant growth in gas reserves and production with gas representing 35% of the Company's total proved reserves and gas and liquids production comprising 32% of the corporate production at December 31, 2001.

Outlook for 2002

Mesquite has identified approximately 25 potential drilling locations to be pursued throughout 2002 in its focused core areas. This drilling program will require access to capital.

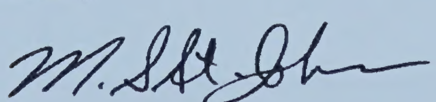
On April 19, 2002, as a result of management's assessment of the most effective way to access the required capital and create incremental shareholder value, Mesquite made a joint announcement with High Point Energy Corp. The companies announced that they have entered in to an arm's length agreement for a business combination ("Combination") pursuant to which High Point will acquire all of the issued and outstanding shares of Mesquite on the basis of three common shares (pre consolidation) of High Point for each common share of Mesquite. The total consideration under the Combination is approximately $48.5 million, comprised of $19.5 million of assumed debt, including $3.0 million principal amount of convertible debenture (which after the consolidation will be converted to High Point shares), and the balance by the issue of High Point common shares.

The Combination is subject to certain conditions, including receipt of all required regulatory approvals. The transaction is expected to be completed on or about mid June 2002. The Combination has the unanimous support of the Board of Directors of both High Point and Mesquite. As well, Griffiths McBurney Partners will render an opinion that the Combination is fair, from a financial point of view, to the Mesquite shareholders.

The management and Board of Mesquite Exploration Ltd. believe that the combination of our solid asset base with this experienced management team and their aggressive plan for growth, will take the shareholders into new areas of opportunity that have the potential to significantly impact shareholder value.

On behalf of the Board of Directors, I would like to thank our shareholders and employees for their support throughout the critical start up phase of the Company.

Sincerely,

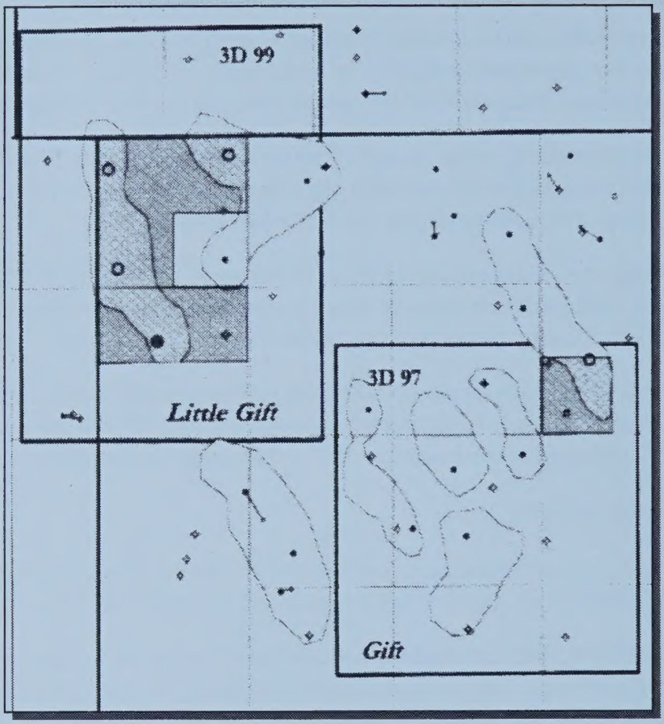


Scott St. John
President

Exploration and Development Program

Gift — Little Gift

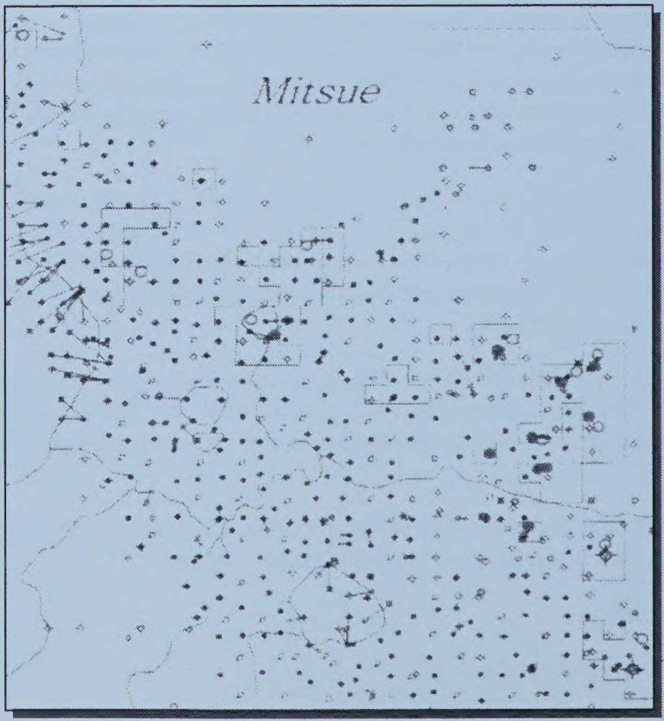
A well was drilled in March 2001. When operations were discontinued in early April 2001, the well had been perforated and swab tested. Swab rates indicated low inflow (10-20) Bbls/d) and it was determined that a frac was necessary. In the first quarter of 2002, the Gift well was fraced and equipped and is on stream at a rate of 60 Bbls/d. The Company will monitor production over the summer and proceed with further drilling during the 2002 winter drilling season.

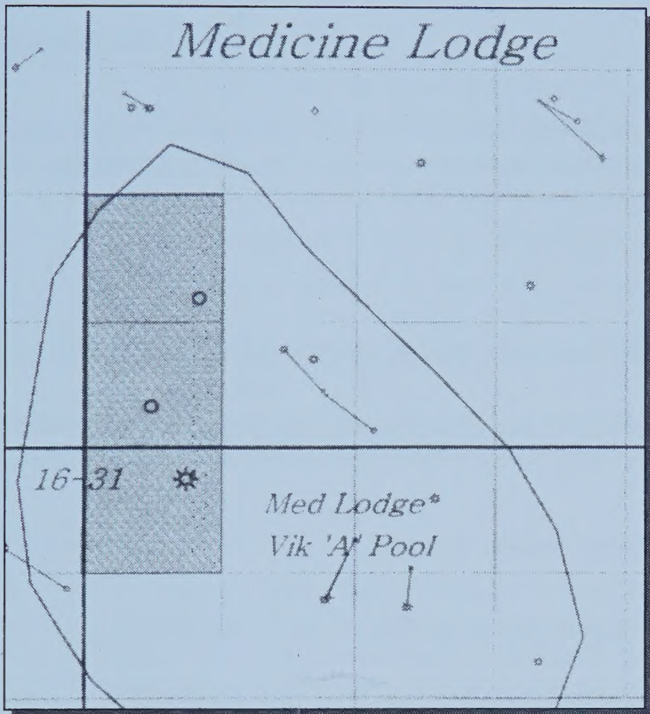


Mitsue

This light oil core area of operations was an area of significant activity for the Company through out the winter drilling season. Six wells were drilled for Gilwood oil, 2 (1.3 net) were drilled and abandoned, 4 (3.2 net) were completed as oil wells, adding additional initial production of 290 Bpd net and reserves of 533 Mbbls net. With the implementation and start up of several waterflood programs in the fall of 2001, production at December 2001 was 571 Bopd net with current production at approximately 600 Bopd net. We are pleased with the results of our optimization efforts in the area and will continue to closely manage the pressure maintenance requirements of the property.

With our 100% owned production facility and an inventory of 12 drilling locations, Mesquite has additional upside to pursue in this area throughout 2002.



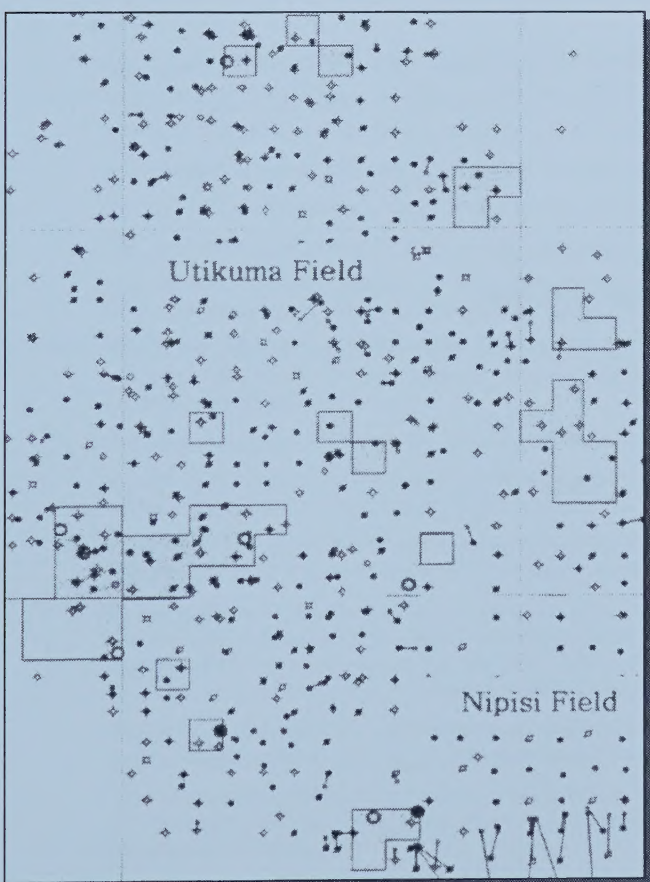


Medicine Lodge

A new area for the Company in 2001, the results at Medicine Lodge provided the Company with excellent growth in both gas production and reserves. Mesquite participated in the drilling of four non operated (0.6 net) wells at Medicine Lodge in 2001, adding 2.9 Bcf of proved reserves net to the Company and booked probable Cardium reserves in two existing well bores.

Initial net production to the Company was 3.3 Mmcf/d plus liquids from the Viking and Belly River formations. Current production is 2.3 Mmcf/d plus liquids of 30 Bpd. A compresssor is currently being installed at a Company owned facility in the area that has the potential to add incremental production of 400 Mcf/d, net to the Company.

The Company currently has 2 Viking and 2 Cardium locations identified to be drilled, each with Belly River potential. As this area is non operated, timing for these wells has not yet been determined.



Utikuma/Nipisi

Mesquite continues to evaluate and develop this original core area property. In 2001, the Company drilled 1 dry hole (.35 net).

Subsequent to year end, 2 Gilwood wells were drilled and cased. The 4-12 well has since encountered water and has been suspended. The 3-2 well is producing 40 Bopd net to the Company. Current production at Utikuma is approximately 155 Bopd net to Mesquite.

This project area has an inventory of 8 drilling locations targeting the Gilwood, Keg River and Slave Point formations. Drilling will continue throughout 2002.

Objective

To increase shareholder value.

While share price of the Corporation will be somewhat determined by investor confidence in the oil & gas industry, the economy in general, and expected future oil & gas prices, the largest factor will be the value of the Corporation's reserve base and our ability to add reserves at a lower cost of capital than our competitors.

Strategies for success

Following a five year plan, the Corporation seeks a growth of 1,000 Boepd each year, and expected to reach 2,000 Boepd by the end of 2001, and 3,000 Boepd by the end of 2002.

Boepd is a measurement of growth of the Corporation that together with efficient operations and favorable commodity prices will provide healthy cash flow and earnings for the Corporation. Those earnings, which are the result of carefully invested capital, hope to increase shareholder value.

Increase value through efficient operations.

Increase cash flow through improved operating efficiencies, thereby reducing overall production costs.

Ensure value is added for the G & A employed.

Making optimal use of credit facilities while maintaining a policy of 'Corporate debt being no greater than 1.5 times annualized cash flow'.

Hedging up to 30% of production to moderate commodity price changes.

Retain a high level of operator ship to control costs and technical input.

Achieve superior return on capital invested.

In determining which oil & gas opportunities to invest in, capital projects must yield the following: 1) Future net revenues from proven plus ½ probable added reserves (at 15% DCF) should be at least twice the invested capital value. 2) At least ½ of the reserves should be remaining after payout. 3) The investment should reach payout in less than 3 years.

Maintain an equal balance between oil and natural gas reserves.

Maintain a 2 to 3 year inventory of undeveloped prospects.

Maintain competitive finding and development, and acquisition costs for added reserves.

Reserve acquisitions must include incremental exploration and development opportunities.

Establish reserves within core areas for more effective control, and dispose of non core properties which are non performing or divert attention and resources away from more valuable core properties.

Marks of success

The Corporation reached exit volumes of 1,808 Boepd. Together with an acquisition of approximately 250 Boepd on January 1, 2002, the Corporation is effectively on target for daily production going into 2002.

The acquisition of KB Resources Inc. in January 2001 provided immediate production growth and added additional exploration opportunities. 9 of the Corporation's 13 wells drilled in 2001 were on lands held by KB Resources Inc.

The Corporation achieved a 61.5% drilling success rate in 2001.

Undeveloped lands acquired in 2001 along with the Corporation's existing lands, will provide new drilling locations through 2002 and well into 2003.

Revenues and production exceeded 150% growth in 2001 over 2000. The proportion of gas to overall production has also increased to 31% at December 31, 2001.

Established reserves have increased 133% in 2001 compared with 2000.

Forward deliverability

With current production levels and pricing, the Corporation has the capacity to replace declines and provide a modest growth in its reserve base during 2002 (forecasted 32%). Working from cash flow, the Corporation expects to have a positive working capital by March 31, 2002, and provide funds for a continued exploration program throughout 2002. In addition to cash flow, an increase in bank debt and a convertible debenture issue, will be the basis for a $15 million dollar capital investment program during 2002 expected to add 907 Boepd of production.

Operations

Gas conversion of Mcf to Boe was changed to 6:1 for 2001, consistent with changing industry reporting practices.

Total production to December 31, 2001 was 476,811 Boe, a 150% increase over the same twelve month period last year. The Corporation produced 128,667 Boe during the fourth quarter of 2001 compared with 79,902 for the same three month period last year.

Daily production averaged 1,399 during the fourth quarter compared with 869 for the same three month period last year, an increase of 61%.

The Corporation's exit production on December 31, 2001 was 1,808 Boepd.

Daily production on December 31, 2001 was made up of 49% light oil, 19% Lloydminster heavy crude, and 32% gas and liquids.

Light crude oil prices averaged $31.68 for the fourth quarter, down from $46.10 for the fourth quarter of 2000. The average price over the entire twelve months ended December 31, 2001 was $39.08 ($45.07 for 2000).

The Corporation had 4% of its production (70 Bbls/d) hedged at December 31, 2001 (at $26.58 U.S.). As contracts were ending during the final quarter of 2001, prices were unfavorable for renewed hedging and it is not until March and April of 2002 that significant hedging is renewed (500 Bbls/d at $21.88 U.S.).

The heavy oil averaged $14.36 over the twelve months ended December 31, 2001, down from $22.83 for 2000.

The Corporation saw its highest ever gas prices during the first quarter of 2001 at $9.38 per Mcf. Prices have declined steadily over the year to average $4.96 for 2001 ($4.76 for 2000). Fourth quarter of 2001 averaged $3.25.

Production revenues from oil and gas production were $11,899,108 for the twelve months compared to $4,687,932 during the same period last year, an increase of 154%. The fourth quarter of 2001 recorded $2,210,422 compared to $1,922,033 for the same three month period in 2000.

Operating expenses for the twelve months ended December 31, 2001 were $8.61 per Boe compared with $5.62 for the same period last year. When oil processing revenues and water disposal revenues from facilities added by the Corporation in 2001 are used to offset operating expenses, the Corporation's net operating expense per Boe is $7.75 for the twelve month period. This is considered a recovery of operating expenses where partners share of oil and water are processed through the Corporation' facilities.

Field net backs provided $16.35 per Boe compared to $19.66 for the same twelve month period last year. A decline in oil and gas prices during 2001 as well as higher operating costs this year have accounted for most of the change.

G & A costs averaged $129,728 per month, or $3.26 per Boe produced during the first twelve months of 2001. Organizational changes associated with the Corporation's decision to create a Production Partnership, costing additional administrative costs, legal, and consulting fees, are reflected in the current G & A expenses.

Operations (continued)

Interest expense was $704,506 for 2001 compared with $71,880 for 2000. This was due to an increase in bank debt of $7.4 million in 2001.

Cash flow was $11.67 per Boe to December 31, 2001, or 32 cents per share, compared with $17.02 per Boe, or 27 cents per share, for the same period last year.

Depletion and depreciation (based upon the unit of production method) was 15% for 2001, or $11.36 per produced Boe, compared with 13.5% or $5.59 per produced Boe for 2000.

The affect of future income taxes on 2001 earnings is a recovery of $96,412 which increased earnings. The future income tax provision for 2001 had recovered from the $719,180 provision made at March 31, 2001. This was largely due to the drop in corporate tax rates by 2% in Alberta. Also the adjustment to future income taxes relating to the purchase price discrepancy of the KB Resources Inc. acquisition, had been restated in the second quarter, due to finalization of the purchase price.

2001 earnings of $172,787 reflect a $0.01 per share earnings compared with $2,478,261 or $0.21 per share for 2000. An increase in depletion and depreciation of $4,448,040, or 400%, is recognized as the major difference.

Balance sheet

Working capital deficiency at December 31, 2001 was $1,901,153, down from $3,299,300 at September 30, 2001, while bank debt was $12,380,500 for a total corporate debt of $14,281,653, down from $15,899,300 at September 30, 2001.

The Corporation's credit facility was increased to $13,500,000 in May 2001. As at December 31, 2001 $12,380,500 had been drawn against the line.

At December 31, 2001, the net book value of property, plant and equipment exceeded the cost basis for income tax purposes (tax pool values) by $11,027,577. As a result, $6,461,979 in future tax liability has been recorded on the balance sheet of the Corporation. This is primarily the result of the acquisition of KB Resources Inc. which added $4,913,797 due to the future income tax affect of the assets acquired without a tax basis. The Corporation's carrying value of future tax liability at December 31, 2000 was $768,510. Tax benefits lost and applied to future tax liability from the renouncement of flow through share tax deductions in 2001 amounted to $876,084. To December 31, 2001 $96,412 in future tax liability is recovered and is credited to earnings.

All diluted share values are reported using the new treasury stock method which was retroactively adopted at January 1, 2001 and is part of the new standards for presentation and disclosure recommended by the Canadian Institute of Chartered Accountants. Under this method, diluted shares were reported to be 17,851,349 at December 31, 2001. The actual number of shares issued and outstanding including warrants and options outstanding at December 31, 2001 is 20,428,618 (18,722,993 basic). The affect on reported earnings per share and cash flow per share for the twelve months ended December 31, 2001 is less than 2 cents per share.

Invested capital

Capital additions of $27,368,163 included $17,401,958 less $863,631 for the acquisition of KB Resources Inc., $10,016,091 in drilling and development additions and other minor acquisitions of $813,745. During the twelve months ended December 31, 2001 the Corporation sold other various interests for net proceeds of $936,256.

KB Resources Inc. was acquired by the Corporation on January 29, 2001 for a cash outlay of $7,539,175 and shares valued at $1,095,430. Expenses incurred by the Corporation, associated with the acquisition were $250,807. The total consideration was $8,885,412. In addition to this consideration KB Resources Inc. carried bank debt of $2,275,000, future site restoration costs of $164,843, future income taxes of $4,913,797, and had a working capital deficiency of $1,162,906. The total cost of the assets of KB Resources Inc. was effectively $17,401,958.

Subsequent to the acquisition, and in conjunction with the funding needed for the acquisition, the Corporation sold 10% of the assets of KB Resources Inc. for the cash consideration of $863,631.

Evaluation of KB Resources Inc. assets at time of deal (000's)

Cash cost of acquisition	
Net asset value	$ 8,636.00
Debt plus working capital deficiency	2,948.50
	$ 11,584.50
Sale value of 10% of assets	
10% of assets	$ 1,158.45
Less: tax pool value lost to Mesquite ($863.6 @ 20% - not compensatedin sale)	(172.67)
Less: fees to purchaser to facilitate closure of KB deal	(122.15)
Cash received	$ 863.63

Source of funds used in asset additions (000's)

Proceeds from sale of assets	$ 936.3
Proceeds from sale of marketable securities	259.7
Issue of shares to KB shareholders	1,095.4
Increase in bank debt	9,705.5
Proceeds from flow through shares issued	2,274.3
Exercise of warrants	1,324.2
Change in working capital	1,237.0
Cash flows for the period	5,565.6
	$ 22,398.0
Additions to book value of assets	$ 27,368.2
Less: non cash - future income taxes	(4,913.7)
- future site restoration costs	(164.8)
Purchase of shares through normal course issuer bids	108.3
	$ 22,398.0

Proven reserves added during the period were 2,030,200 Boe at an 'all in' finding, development and acquisition cost of $13.48 per Boe. While this number includes the future tax liability associated with the purchase of the KB Resources Inc. assets, the actual 'cash spent' on finding and development was $10.98 per Boe.

Established reserves added were 2,317,800 Boe at an 'all in' cost of $11.81 per Boe. On a 'cash spent' basis (net of the future tax liability and future site restoration costs in KB Resources Inc.) the all in cost of established reserves was $9.62 per Boe.

Net asset value

Net asset value at December 31, 2001 using 15% DCF on proven plus half probable is estimated to be $1.27 per share (12% DCF is $1.44).

The Corporation's engineering report at December 31, 2001 shows total proven reserves at 2.67 million Boe (gas at 6:1). Using escalating prices and 15% DCF, present value of total proven reserves is currently reported at $28.76 million dollars.

At December 31, 2001 the total proven plus half probable reserves are estimated to be 3.22 million Boe with 15% discounted cash flows of $32.8 million dollars.

Subsequent to 2001

Effective January 1, 2002 the Corporation disposed of four producing wells in non core areas for gross proceeds of $632,500. The proceeds were added to the Corporation's working capital. December production from the sold wells had been 51 Boepd net to the Corporation.

Effective January 1, 2002 the Corporation purchased the working interests of a related company for $6,606,000. The production is expected to be 250 Boepd net to the Corporation and is in the same properties which the Corporation already has an interest. The funding for the acquisition is from a $3,000,000 bank line increase, $606,000 of working capital, and $3,000,000 in the form of a convertible debenture issued to the vendor.

Effective March 1, 2002 the Corporation disposed of 30% working interest in section 19 at Mitsue to non related parties for gross proceeds of $750,000. The proceeds were added to the Corporation's working capital. The working interest sold represented 22 Boepd of production lost to the Corporation.

Business risk

The business of exploring for, developing and producing oil and natural gas reserves is inherently risky. There is substantial risk that the manpower and capital employed do not result in the finding of new reserves in economic quantities. The price Mesquite receives for its oil and gas reserves fluctuates continuously and, for the most part, is beyond our control. Mesquite is also subject to the risks associated with owning oil and gas properties, including environmental risks such as the pollution of air, land and water. In all areas of our business, we compete against entities that may have greater technical and financial resources. Mesquite's growth is dependent in part upon external sources of financing which may not be available on acceptable terms.

Mesquite mitigates these risks by hiring highly qualified personnel, either directly as employees or indirectly by contracting for services. Our philosophy of focusing in a limited number of areas allows us to develop a high level of technical and managerial expertise in each area. To control the cost and risk of development, we acquire reasonable interests in each prospect and operate whenever possible. Mesquite also enters into commodity price hedging strategies to add a degree of certainty to cash flow. We diversify our oil and gas market portfolio among various marketers and aggregators and among a variety of contracts with respect to pricing and term. In the field, we adhere to sound operational standards, which meet or exceed recognized levels. Finally, all levels of our operations are adequately insured.

Auditor's Report

Deloitte & Touche
3000, 700 Second Street SW
Calgary, AB
Canada T2P 0S7

We have audited the consolidated balance sheets of **Mesquite Exploration Ltd.** as at December 31, 2001 and 2000 and the consolidated statements of earnings, deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP
Chartered Accountants

Calgary, Alberta
March 6, 2002

Balance Sheets *as at December 31, 2001 and 2000*

	2001 $	2000 $
Assets		
Current		
Cash	342,123	52,811
Marketable securities	-	196,000
Accounts receivable	4,127,785	5,342,050
Prepaid expenses and deposits	282,343	6,653
	4,752,251	5,597,514
Property and equipment (Note 4)	32,051,807	11,065,947
	36,804,058	16,663,461
Liabilities		
Current		
Accounts payable and accrued liabilities	6,653,404	6,047,910
Long-term debt (Note 5)	12,380,500	2,675,000
Provision for future site restoration and abandonment costs	472,367	200,693
Future income taxes (Note 8)	6,461,978	768,510
	25,968,249	9,692,113
Shareholders equity		
Share capital (Note 6)	11,898,863	8,144,096
Deficit	(1,063,054)	(1,172,748)
	10,835,809	6,971,348
	36,804,058	16,663,461

Approved by the board

Director

Director

Consolidated Statements of Earnings *years ended December 31, 2001 and 2000*

	2001 $	2000 $
Revenue		
Petroleum and natural gas, net of royalties and credits	11,488,480	4,687,932
Other income	33,027	43,193
	11,521,507	4,731,125
Expenses		
Operating	3,693,813	1,043,030
General and administration	1,556,740	459,891
Depletion and depreciation (Note 2)	5,552,878	1,104,838
Interest	704,506	71,880
	11,507,937	2,679,639
Earnings from operations	13,570	2,051,486
Gain on sale of assets	63,700	187,851
Earnings before income taxes	77,270	2,239,337
(Provision for) Recovery of income taxes		
Current	(895)	-
Future (Note 8)	96,412	238,924
	95,517	238,924
Net earnings	172,787	2,478,261
Net earnings per weighted average share		
Basic	0.01	0.21
Diluted	0.01	0.19
Weighted average shares		
Basic	17,157,742	11,820,827
Diluted	17,851,349	13,335,009

Consolidated Statements of Deficit *years ended December 31, 2001 and 2000*

	2001 $	2000 $
Deficit, beginning of year	(1,172,748)	(3,634,214)
Shares purchased for cancellation (note 7)	(63,093)	(16,795)
Net earnings	172,787	2,478,261
Deficit, end of year	(1,063,054)	(1,172,748)

Statements of Cash Flows *for the years ended December 31, 2001 and 2000*

	2001 $	2000 $
Operating		
Net earnings	172,787	2,478,261
Adjustments for:		
Depletion and depreciation	5,552,878	1,104,838
Provision for future income taxes	(96,412)	(238,924)
Gain on sale of assets	(63,700)	(187,851)
	5,565,553	3,156,324
Changes in non-cash working capital	1,256,437	670,269
	6,821,990	3,826,593
Financing		
Decrease in short-term loan	-	(187,096)
Increase in long-term debt	7,430,500	2,138,957
Repurchase of shares - normal course issuer bid	(108,362)	(27,045)
Proceeds from exercise of warrants, net of costs	1,324,223	-
Proceeds from flow-through share issue, net of costs	2,274,334	2,533,492
	10,920,695	4,458,308
Investing		
Additions to oil and gas properties	(10,016,091)	(7,346,724)
Acquisitions of oil and gas properties (Note 3(b))	(813,745)	(2,151,206)
Cash paid for acquisition of oil and gas company (Note 3(a))	(7,789,982)	(876,000)
Bank indebtedness acquired at acquisition (Note 3(a))	(893,142)	-
Proceeds on sale of oil and gas properties	1,799,887	26,238
Proceeds on sale of marketable securities	259,700	2,060,446
	(17,453,373)	(8,287,246)
Net increase (decrease) in cash	289,312	(2,345)
Cash, beginning of year	52,811	55,156
Cash, end of year	342,123	52,811
Cash flow per share		
Basic	0.32	0.27
Diluted	0.31	0.24
Weighted average shares		
Basic	17,157,742	11,820,827
Diluted	17,851,349	13,335,009
Supplementary information		
Interest paid	704,506	71,880
Taxes paid	895	-

1. Nature of operations

The Corporation is incorporated in the province of Alberta and is engaged in the exploration for, and development and production of, oil and natural gas in Alberta and Saskatchewan.

Certain of the Corporation's exploration, development and production activities are conducted jointly with others and, accordingly, the accounts include only the Company's proportionate interest in such activities.

2. Significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following significant accounting polices:

Basis of presentation

These consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries.

Cash and cash equivalents

Cash and cash equivalents are comprised of cash on hand and demand deposits with an original maturity of less than three months.

Property and equipment

Capitalized costs

The Corporation follows the full-cost method of accounting for petroleum and natural gas properties whereby all costs relating to acquisition of, exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on non-producing properties, costs of drilling productive and non-productive wells and well equipment costs. Proceeds from disposal of properties are normally applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case, a gain or loss on disposal is recorded.

Depletion and depreciation

Depletion of oil and gas properties is provided using the unit-of-production method based on estimated proven reserves of oil and gas before royalties as determined by independent petroleum engineers. Units of natural gas reserves have been converted to equivalent barrels of oil, based on the ratio of six thousand cubic feet of gas to one barrel of oil.

Production equipment is recorded at cost and is depreciated, net of estimated residual value, using the unit-of-production method on the estimated useful life of reserves. Office furniture and equipment is depreciated using the declining-balance method at rates varying from 20% to 30%.

Future site restoration and abandonment costs

The estimated costs for future site restoration and abandonment costs are provided for on the unit-of-production basis. Costs are estimated each year by management in consultation with the Corporation's engineers based on current regulations, costs, technology and industry standards. The annual charge is included in depletion and depreciation expense, and actual site restoration and abandonment costs are charged to the accumulated provision account as incurred.

Revenue recognition

Petroleum and natural gas sales are recognized when commodities are sold.

Ceiling test

The Corporation applies a ceiling test quarterly to capitalized costs, net of future income taxes, to ensure such costs do not exceed the estimated value of future net revenues from production of proven reserves, plus the lower of cost and estimated fair value of undeveloped lands, less future general administrative expenses, future site restoration and abandonment costs, financing costs and income taxes. Any reduction in value as a result of the ceiling test is charged to operations. Future net revenues are estimated using year end prices and all costs are assumed to be constant.

Flow-through shares

The Corporation has financed a portion of its exploration and development activities through the issue of flow-through shares. Under the terms of these share issues, the tax attributes of the related expenditures are renounced to subscribers. Share capital is reduced by an amount equal to the estimated future income taxes payable by the Corporation as a result of the renunciations and the estimated future income taxes payable are recorded as an increase to the future income tax liability.

Income taxes

Due to changes in Canadian generally accepted accounting principles effective January 1, 2000, the Corporation was required to change its method of accounting for income taxes. The Corporation has retroactively implemented the tax payable method of accounting for income taxes with no restatement of prior years' financial statements. Under the tax payable method, the temporary differences arising from differences between the tax basis of an asset or liability and its carrying value on the balance sheet are used to calculate the future income tax assets or liabilities. Future income tax assets or liabilities are calculated using income tax rates expected to apply in the year in which the temporary differences are expected to reverse. Temporary differences arising on acquisitions result in a future income tax asset or liability.

Significant accounting policies ***(continued)***

Marketable securities

Marketable securities are recorded at the lower of cost and market value.

Financial instruments

The Corporation periodically enters into crude oil and natural gas hedging contracts to manage the Corporation's exposure to commodity price fluctuations. No contracts are entered into for trading purposes. Revenue is adjusted for these transactions when the related production is sold.

The credit exposure relating to the use of financial instruments results from the possibility that a counterparty to a derivative in which the Corporation has an unrealized a gain, fails to perform according to terms of contract. Credit exposure is minimized by only dealing with credit worthy counterparties.

Financial instruments include accounts receivable, accounts payable and accrued liabilities, and long-term debt. The fair value of accounts receivable and accounts payable and accrued liabilities are equivalent to their carrying value because of the short-term maturity of those financial instruments. Long-term debt is borrowed at market interest rates and book value approximates market value.

As the Corporation's long-term debt bears interest at various rates based on the bank's prime rate, the Corporation is subject to interest rate fluctuations.

Stock-based compensation plan

The Corporation has a stock-based compensation plan, which is described in Note 6(b). No compensation expense is recognized for these plans when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital.

Dilutive effect of stock options

Effective January 1, 2001, the Corporation retroactively adopted the new standards for presentation and disclosure of earnings per share as recommended by the Canadian Institute of Chartered Accountants. The new standard relates to the computation, presentation and disclosure of earnings per share and cash flow from operations per share. Under the new standard, the treasury stock method is used to determine the dilutive effect of stock options and warrants. The treasury method assumes that proceeds from the exercise of "in-the-money" stock options are used to repurchase the common shares at the prevailing market rate. The effect of the application of the new standard was no change to diluted earnings per share for the year ended December 31, 2001 ($0.03 for 2000). The effect of the new standard to diluted cash flow from operations was an increase of $0.01 for the year ended December 31, 2001 ($0.04 for 2000).

3. Acquisitions and disposals

2001

Effective January 29, 2001, the Corporation acquired all of the issued and outstanding shares of KB Resources Inc. ("KB") for a cash consideration of $7,539,175 and shares at fair market value of $1,095,430. In addition, $250,807 of related acquisition costs have been capitalized in relation to the acquisition.

KB continues to operate as a 100% owned subsidiary of the Corporation. KB has been accounted for as a purchase with the results of operations included in these consolidated financial statements from the date of acquisition.

Net assets acquired are as follows	$
Petroleum and natural gas properties acquired	17,401,958
Working capital deficiency	(1,162,906)
Debt	(2,275,000)
Site restoration	(164,843)
Future income taxes	(4,913,797)
	8,885,412
Consideration given in cash	7,539,175
Consideration given in shares	1,095,430
Capitalized costs relating to the acquisition	250,807
	8,885,412

Effective January 29, 2001, the Corporation disposed of 10% of the petroleum and natural gas properties of KB. for net cash consideration of $863,631. This was done to facilitate closure of the acquisition. During the year ended December 31, 2001, the Corporation also sold various interests for net proceeds of $936,256. Additional working interests in core areas were acquired during the year for $813,745.

Acquisitions and disposals *(continued)*

2000

The Corporation acquired all of the issued and outstanding shares of Kispiox Resources Ltd. ("Kispiox"), effective June 1, 2000 for cash consideration of $876,000. The acquisition gave the Corporation operatorship in a new core area, Utikoomak. Prior to the acquisition, 100% of the shares of Kispiox were owned by a majority shareholder of the Corporation. The fair market value of the net assets was determined through an independent valuation. The purchase price has been allocated as follows:

	$
Net assets acquired at fair value - petroleum and natural gas properties	1,335,754
Provision for site restoration	(15,373)
Working capital	89,614
Other	2,048
Debt	(536,043)
Consideration given	876,000

Kispiox was amalgamated with the Corporation September 2000.

Effective May 1, 2000, the Corporation acquired an original interest in the Utikoomak area for the sum of $605,210. Effective July 1, 2000, the Corporation purchased a working interest in a new core area, Mitsue, for $1,203,061. Additional minor interests and non-producing lands were acquired in the core areas of Progress, Utikoomak and Mitsue for a further $342,935.

4. Property and equipment

During the year ended December 31, 2001, additions to property, plant and equipment through drilling, completion and equipping amounted to $10,016,091. The acquisition of KB Resources Inc. added $12,488,161 which included an adjustment for future taxes on the purchase price discrepancy and the cost of KB's debt and working capital deficiency. Other minor acquisitions added $813,745 while disposals equaled $1,799,887. The current provision for depletion and depreciation was $5,446,047.

Included in oil and gas properties for 2000 is capitalized general and administrative expenses of $96,138. There were no capitalized administrative expenses in 2001.

The Corporation has excluded undeveloped property with a carrying value of $1,196,270 from its depletable base (2000 - $180,154). The provision for abandonment of $106,831 for the year ended December 31, 2001 is included in depletion and depreciation expense (2000 - $59,445).

	2001		
	Historical Cost $	Accumulated Depletion and Depreciation $	Net Book Value $
Intangible well costs	38,475,541	11,918,180	26,557,361
Equipment costs	6,545,267	2,333,405	4,211,862
Non-producing properties	1,196,270	-	1,196,270
Other assets	282,956	196,642	86,314
	46,500,034	14,448,227	32,051,807

	2000		
	Historical Cost $	Accumulated Depletion and Depreciation $	Net Book Value $
Intangible well costs	11,744,184	2,289,346	9,454,838
Equipment costs	1,825,550	422,569	1,402,981
Non-producing properties	180,154	-	180,154
Other assets	74,780	46,806	27,974
	13,824,668	2,758,721	11,065,947

5. **Long-term debt**

In May 2001, the Corporation obtained a revolving operating demand loan facility from the National Bank of Canada bearing interest at prime plus 3/4% to a maximum of $13,500,000. As of December 31, 2001, $12,380,500 had been drawn against the loan. This loan is secured by a registered general assignment of book debts in the provinces in which the Corporation operates, a first fixed and floating charge debenture in the minimum face amount of $20,000,000 with an undertaking to provide the first charges over major petroleum properties of the Corporation at the request of the bank and an assignment of material contracts. During the year, the Corporation incurred $660,825 (2000 - $64,593) of interest on its long-term debt.

6. **Share capital**

Authorized

Unlimited number of common shares
Unlimited number of preferred shares of one or more series

a) Common shares	**Number of shares**	**Amount $**
Issued and outstanding		
Balance at December 31, 1999	11,437,162	**6,628,287**
Flow through shares issued in September 2000	1,200,000	**1,200,000**
Flow through shares issued in December 2000	1,129,630	**1,525,000**
Share issue costs, net of taxes	-	**(106,057)**
Tax benefits renounced from flow through shares and warrants	-	**(1,092,884)**
Shares retired through normal course issuer bids	(25,000)	**(10,250)**
Balance at December 31, 2000	13,741,792	**8,144,096**
Conversion of warrants	2,731,316	**1,307,723**
Shares issued on acquisition of KB Resources Inc.	995,846	**1,095,430**
Shares retired through normal course issuer bids	(77,200)	**(45,270)**
Share issue costs	-	**(38,020)**
Tax benefits renounced from flow through shares		**(876,084)**
Options exercised	16,667	**16,500**
Flow through shares issued in November 2001	1,314,572	**2,294,488**
Balance at December 31, 2001	18,722,993	**11,898,863**

b) Stock options

	2001		**2000**	
	Number of shares	**Weighted average exercise price $**	**Number of shares**	**Weighted average exercise price $**
Outstanding, beginning of year	1,118,339	0.82	333,337	0.45
Granted	-	-	785,002	1.00
Exercised	(16,667)	0.99	-	-
Expired	(53,333)	-	-	-
Outstanding, end of year	1,048,339	0.82	1,118,339	0.82
Exercisable, end of year	579,737		428,299	

6. Share capital *(continued)*

	Options Outstanding			Options Exercisable	
	Number outstanding	Weighted average remaining life (years)	Weighted average exercise price $	Number exercisable	Weighted average exercise price $
Range of exercise prices					
$0.45	333,337	2.7	0.45	222,236	0.45
$0.69 - $0.72	85,001	3.5	0.71	42,501	0.71
$0.80 - $0.90	105,001	3.3	0.87	52,500	0.87
$1.00 - $1.20	525,000	3.9	1.06	262,500	1.06
	1,048,339	3.4	0.82	579,737	0.78

On October 14, 2001, 16,667 options were exercised for an average of $0.99 per share for proceeds of $16,500.

c) Flow-through shares

In November of 2001, the Corporation issued 1,314,572 flow-through shares at $1.85 per share for gross proceeds of $2,431,958 before deducting issuance costs of $137,471. $531,535 will be renounced to the shareholders in 2001 while the balance of $1,900,423 was renounced to the shareholders in 2001 under the "look back" provision governing flow-through shares and will be expended in 2002. The tax benefit on expenditures made by the Corporation in 2001 from this issue was $226,434 and has been applied to share capital. As at December 31, 2001, $531,535 has been expended of the total to be renounced to the shareholders.

On December 21, 2000, the Corporation sold 1,129,630 flow-through shares at $1.35 per share for gross proceeds of $1,525,000 before deducting issuance costs of $98,999 including the agent's commission of 6%. In 2001 $1,525,000 has been renounced under the "lookback" provision governing flow-through shares. The tax benefit renounced by the Corporation in 2001 was $649,250 and was applied to share capital. As at December 31, 2001, all expenditures were completed.

In September 2000, the Corporation issued 1,200,000 flow-through shares at $1 per share for gross proceeds of $1,200,000 before deducting issuance costs of $92,509. The tax benefit renounced to the shareholders in 2000 has been applied to share capital. As at December 31, 2001, all expenditures were completed.

d) Warrants

On January 15, 2001, 1,254,902 warrants due to expire on July 30, 2001 were exercised and exchanged for an equal number of shares of the Corporation for an additional consideration of $0.30 per share. On February 21, 2001, 493,827 warrants due to expire April 27, 2001, and 668,861 warrants due to expire on May 2, 2001 were exercised and exchanged for an equal number of shares of the Corporation for an additional consideration of $0.72 per share. During the second and third quarters, 313,725 warrants were exercised and exchanged for an equal number of shares of the Corporation for additional consideration of $0.30 per share, 94,117 warrants due to expire on July 30, 2001 were exercised and exchanged for an equal number of shares of the Corporation for an additional consideration of $0.30 per share. During the third quarter, 219,608 warrants exercisable into an equal number of common shares of the Corporation at a rate of $0.30, expiring on July 30, 2001 were exercised.

In conjunction with the flow-through shares issued in November of 2001, one half of one warrant was also issued for each flow-through share issued. 657,286 warrants to purchase an equal number of common shares of the Corporation upon payment of additional consideration of $1.90 per share were issued. The warrants expire on December 31, 2002. As of December 31, 2001, there are 657,286 warrants outstanding.

7. Normal course issuer bid

On March 31, 2000, the Corporation announced its intention to make a normal course issuer bid.

During 2001, 77,200 (2000 - 25,000) common shares were repurchased with $45,270 (2000 - $10,250) being allocated to share capital and $63,093 (2000 - $16,795) to deficit.

8. Income taxes

The components of the future income tax liability at December 31, 2001 are as follows:

	2001 $	2000 $
Future income tax liabilities on capital assets	7,030,962	978,080
Future income tax assets		
Attributed Crown Royalty income carryforward	(159,162)	(52,326)
Future site restoration costs	(201,228)	(89,549)
Resource allowance rate reduction	(6,862)	38,816
Share issue costs	(201,732)	(106,511)
Net future income tax liability	6,461,978	768,510

The acquisition of KB Resources Inc. added $4,913,797 due to the future income tax affect of the assets acquired without a tax basis, plus the carrying value of the future tax liability. Tax benefits renounced and applied to the future tax liability from the renouncement of flow-through share tax deductions in 2001 amounted to $876,084.

The total income taxes are different than the amount computed by applying the combined expected Canadian and provincial tax rates of 42.62 (2000 - 44.62%) to income before taxes.

This difference results from the following:

	2001 $	2000 $
Computed expected tax	32,536	999,192
Non-deductible Crown royalties	1,240,654	456,362
Gain on disposal of marketable securities	(13,568)	(26,311)
Resource allowance	(830,271)	(507,461)
Utilization of loss carry-forward benefit	(468,980)	(734,648)
Recognition of previously unrecognized temporary differences	-	(467,892)
Resource rate tax reduction	(6,861)	38,816
Other	(49,922)	3,018
Recovery of future income taxes	(96,412)	(238,924)

9. Sales hedging

Hedging information

	Barrels Per Day	Price Per Barrel US$
Light oil is hedged at US$26.58 from September 1, 2001 to February 28, 2002	70	26.58

10. Subsequent events

Effective January 1, 2002, the Corporation disposed of four producing wells in non-core areas for gross proceeds of $632,500. The proceeds were added to the Corporation's working capital.

Effective January 1, 2002, the Corporation made an offer to purchase the working interests of a related company for $6,600,000. The acquisition would increase the Corporation's share of ownership in properties where it already has a working interest. The acquisition would involve $3,600,000 in cash, and $3,000,000 by way of a convertible debenture issued to the vendor. The cash would be provided from an increase in bank debt of $3,000,000 and $600,000 from working capital. The offer has been accepted by the vendor, and is subject to final bank and regulatory approvals to complete the acquisition.

Statements throughout this annual report that are not historical facts may be considered "forward looking statements." These forward looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Company's objectives, goals or future plans are forward looking statements. Since forward looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties and actual results could differ materially from those currently anticipated.

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MESQUITE EXPLORATION LTD.